

Six Design Principles for Bank Risk and Control Operating Model Transformations in 2024



Executive Summary

Why is this briefing note important?

This briefing note functions as a starting point for banks' senior management to identify key priorities and design decisions for risk and control target operating model (TOM) transformations in 2024. It has been developed by identifying the key supervisory priorities of the UK and EU regulators, analysing strategic risk management trends in the industry, and leveraging Avantage Reply's insights from developing target operating models for a range of risk and control functions at some of the most significant financial institutions across Europe.

Six design principles have been identified as being the most influential for informing strategic design decisions for upcoming risk and control transformations (Figure 1). It accounts for a range of industry-wide forces influencing the fundamental architecture of banks in 2024, such as stricter regulatory scrutiny, deployment of novel technologies, and climate change. These principles can be used by a range of bank stakeholders responsible for their firms' risk and control architecture, in shaping function-specific enhancements for 2024, as well as steering overall firm risk strategy.

Who should read this briefing note?

- Relevant management body members (CEO, COO, CRO etc.)
- Members of the board
- Heads of risk and control functions
- Internal strategy functions
- Internal auditors

What purpose do these design principles serve?

- Steering the articulation of key priorities for bank risk and control TOM transformations
- Identifying key regulatory priorities in the UK and EU for 2024
- Summarising select industry best practices to embed the identified risk priorities

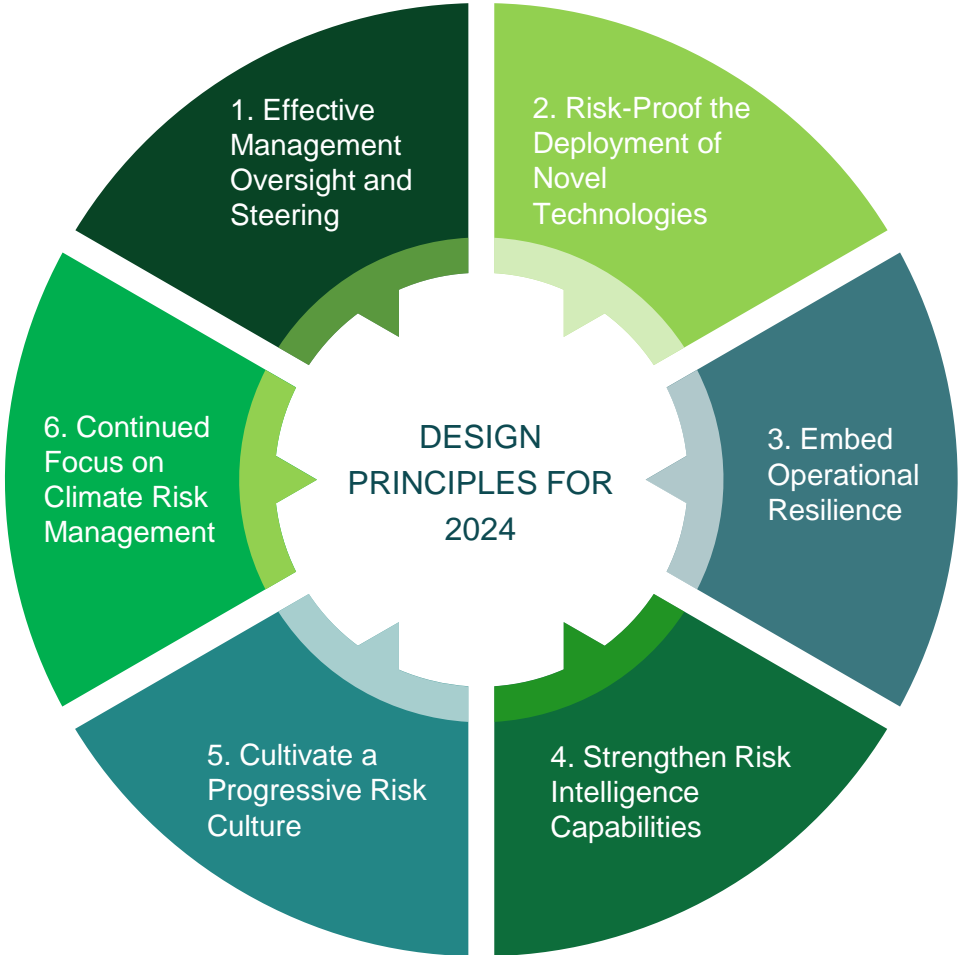


Figure 1: Design Principles for Risk and Control Operating Model Transformations in 2024



1. Effective Management Oversight and Steering

A key takeaway noted in the Federal Reserve’s report on Silicon Valley Bank’s collapse in early 2023 was the failure of the management body to accurately identify and manage risk. The aftermath of the collapse induced industry-wide introspection on whether management oversight capabilities were fit for purpose. Risk and control transformations in 2024 must be driven by the understanding that the management body has a central role in managing risk within the organisation.

The policy positions adopted by both the UK and EU regulators in 2024 on the governance capabilities of management bodies stress on some common themes, including board oversight effectiveness, role in risk culture, and diversity. A comparative view of the key priorities is presented in **Figure 2**. Risk and control operating models in 2024 must prioritise the following considerations whilst defining a role for management bodies in managing risk:

Role in Strategic Initiatives: In 2023, both the UK and EU regulators have released numerous policy positions on novel risk and regulatory areas, such as AI and operational resilience, among others. Across these initiatives, the regulators have stressed the role of management bodies in playing an active role in overseeing implementation, identifying risks, and developing a strong control architecture. Hence, the operating models emerging from these novel initiatives must clearly evidence the oversight, risk management capabilities, and accountabilities of the management body.

Composition and Challenging Capacity: In line with the discussion on novel initiatives, the composition of the board will be a top priority in 2024. Avantage Reply’s engagement with firms has noted management bodies often not possessing sufficient capabilities to foster strong internal debate and steer critical initiatives, particularly on novel risk areas. Thus, assessing the suitability of the board’s composition is a key priority. Appropriate tools, such as the European Banking Authority’s suitability matrix, or external reviews, can be helpful in determining whether the board has the appropriate skills, knowledge, and traits to effectively identify and manage risk.

Role of Independent Directors: The European Central Bank (ECB) has been particularly vocal about the influence of non-executive directors (NEDs) in shaping board debate. Surveys conducted by the ECB indicate that in a third of supervised firms, less than half of the board is made up of NEDs. Governance best practices, such as conducting closed committee sessions for NEDs only, can be potential solutions for operating model transformations.

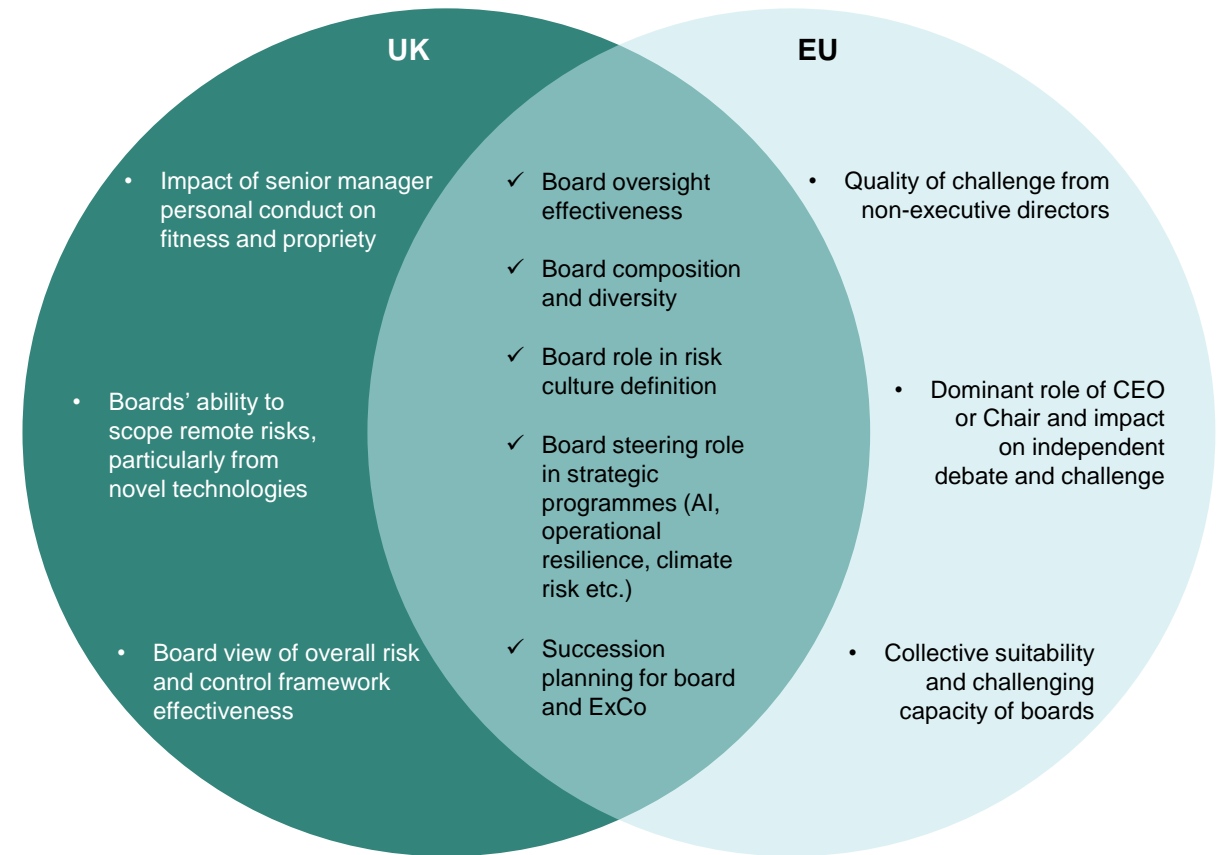


Figure 2: Comparative View: UK and EU Priorities for Management Bodies in 2024



2. Risk-Proof the Deployment of Novel Technologies

Digital transformations have emerged as a top priority for a wide range of firms. At the top of the agenda, has been the deployment of artificial intelligence (AI) and machine learning (ML). In 2023, Avantage Reply's engagement with firms observed the launching of initiatives to explore the adoption of AI/ML within their operating models, despite actual embedment remaining less notable. A survey of UK Finance member firms noted enhancements in productivity, operational effectiveness, and cost savings as some key perceived adoption benefits of these technologies (**Figure 3**). A survey from the Bank of England has also noted that risk, control, and compliance functions have one of the strongest use cases for such technologies (**Figure 4**). Beyond AI, several firms have also embraced cloud capabilities, blockchain technology, and robotic process automation.

Both the ECB and the Prudential Regulation Authority (PRA) have highlighted the importance of firms adopting appropriate safeguards to limit risks arising from the adoption of new technologies. In 2024, risk and control operating model transformations must therefore de-risk the deployment of such technologies, not just their own functions, but across the bank's operating model. Key priorities include:

Ensure Data Integrity for Digital Transformations: Firms must start their digital transformation journey by ensuring the integrity and quality of their source data. Poor quality data, particularly for AI/ML-driven risk technologies, can result in inaccurate risk identification, alert creation mechanisms with poor transparency, security concerns, and biased decision-making. In line with [BCBS recommendations](#), firms should consider the use of common data taxonomies to enhance consistency in data standards, the maintenance of data lakes with a high degree of scalability, and embedding a strong quality assurance culture by allocating responsibilities across the organisation.

Build Contingency Capabilities for the Organisation: Firms should commence the development of response and recovery strategies for scenarios where it is no longer able to rely on a newly deployed technological solution. Risk and control operating models should possess contingency capabilities or playbooks to ensure that key processes across the organisation reliant on failed novel technologies can continue to operate. This remit should hence extend beyond the failure of just risk or control processes.

Collaboration Across the Organisation in Steering Adoption: Avantage Reply's engagement with the industry has already revealed various firms receiving regulatory inquiries on the adoption of novel technologies. Regulators have responded positively to collaboration across key functions on steering the adoption of novel technologies. A fluid cadence of interaction between first line risk and control functions, second line oversight, front office, legal, operations, and others is likely to ensure a uniform understanding of the risk profile of novel technologies and priorities to manage emerging risks.

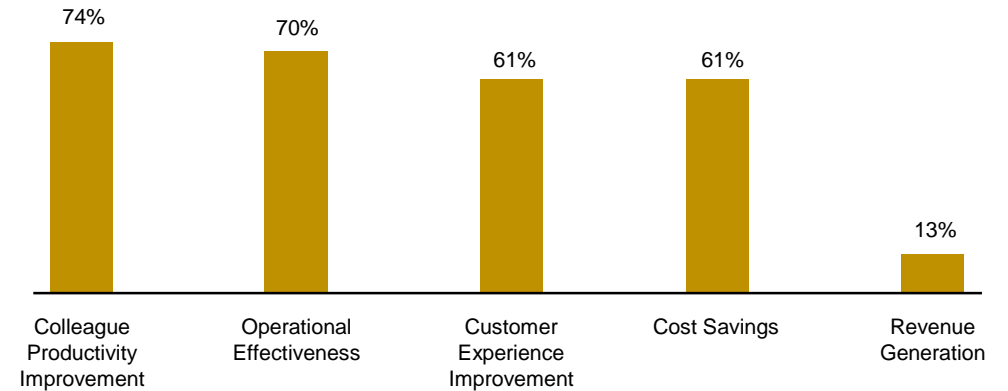


Figure 3: Perceived Benefits of Generative AI in Financial Institutions – [UK Finance 2023](#)

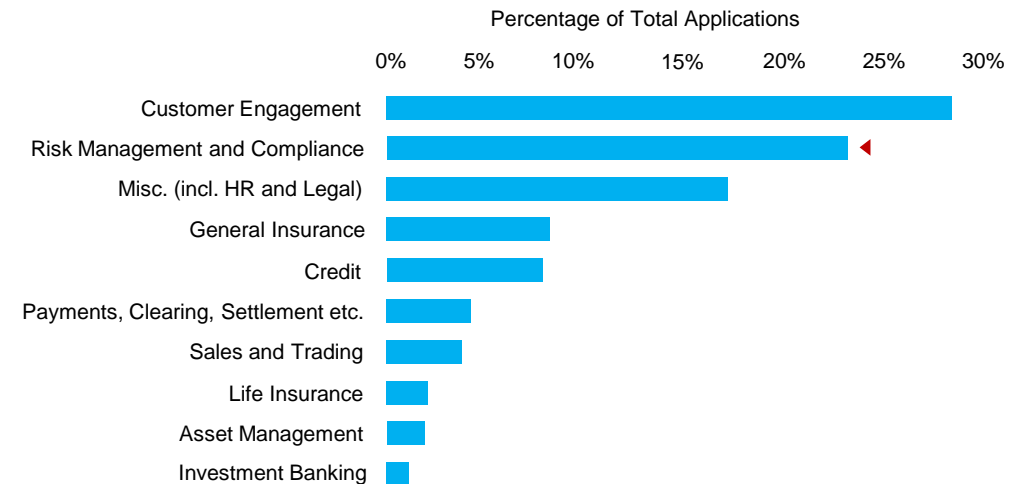


Figure 4: Range of AI/ML Applications Across Business Areas – [Bank of England 2022](#)



3. Embed Operational Resilience

Both the UK and EU regimes on operational resilience is set to apply to firms in scope from Q1 2025 (Figure 5). Thus, 2024 is the final year firms have to implement its operational resilience programmes and evidence their capabilities to comply with the regulations. As a result, programmes must shift their focus from the definition phase to the piloting and remediation phases.

What Happens in 2024?

Final Push to Remain within Impact Tolerances: In the UK, 2024 will be the final year for firms to embed their target operating models for operational resilience and demonstrate the ability of their important business services (IBS) to remain within impact tolerances. Remediation of pending regulatory feedback and gaps in capabilities must be a top priority. The UK regulators are also expected to finalise the proposed critical third-parties (CTP) regime and consult on a new policy regime on outsourcing and third-party reporting. Cyber resilience will be a central priority, with the PRA's 2024 priorities expecting firms' scenario assessments to include cyber-related disruptions.

Continued Regulatory Developments in the EU: With operational resilience being a key theme in the ECB's 2024 supervisory priorities, the EU regulators have confirmed their intention to conduct targeted reviews into firms' resilience management capabilities. There has been a particular emphasis on cybersecurity, with the ECB expected to conduct a thematic stress test on cyber resilience in 2024. The DORA regulatory technical standards (RTSs) will also be finalised in 2024 as the EC ratifies the ESA's final drafts.



Firms should have a clear plan to identify and remediate any vulnerabilities which could impact their ability to deliver their IBS. This includes identifying which resources are needed to support the delivery of each IBS, running tests using scenarios which are severe but plausible, and learning lessons from any operational disruptions.

International Banks Supervision: 2024 Priorities – PRA 2024

Impact on Firm Transformations



Focus on Resilience Maturity: Under both the UK and EU regimes, firms will be expected to ensure that their operational resilience framework is fit for purpose to go live in 2025. Firms' target operating model must be assessed against regulatory expectations. Remediation of pending gaps, regulatory feedback, or internal audit points should be a top priority. Throughout 2024, it will be crucial for firms to start resilience training and awareness initiatives across their organisation so that key responsible staff are aware of their obligations for Q1 2025.



Piloting the Operating Models: To secure assurance on the effectiveness of their resilience target operating models, firms must commence a phase of piloting in 2024. Comprehensive lessons learned exercises must be conducted based on piloting outcomes. Senior management stakeholders should also commence preparations for detailed regulatory engagements and be ready to evidence their involvement in operational resilience management within their firms.

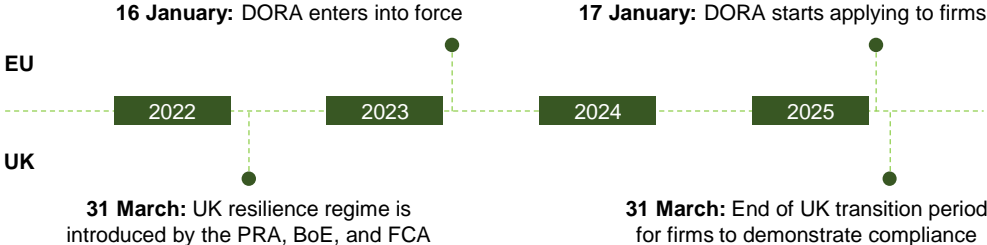


Figure 5: Timeline of EU and UK Operational Resilience Regulations



4. Strengthen Risk Intelligence Capabilities

The ECB's [2023 SREP exercise](#) concluded that there has been insufficient progress among financial institutions in complying with the risk data aggregation and reporting (RDAR) standards set out in BCBS 239. In November 2023, the [BCBS's report](#) on the progress of firms in adopting BCBS 239 also found delays in implementation, weaknesses in aggregation methodologies, and insufficient oversight from management teams. Avantage Reply's engagement with firms has also observed the underfunding of adoption and remediation programmes, legacy systems, and the resulting use of supervisory actions consistent with the BCBS's findings on supervisory measures in **Figure 6**.

As a result, risk and control functions are likely to face targeted reviews on their risk intelligence capabilities in 2024. Forthcoming operating model transformations must therefore account for the following priorities:

Senior Management Ownership: A critical success factor for building strong risk intelligence capabilities is strong board and senior management ownership. Firms must assign accountabilities to relevant senior managers to prioritise and oversee the adoption of regulatory standards, and the development of bespoke data governance frameworks, aggregation methodologies, and quality maintenance procedures. This should be complemented by a clear allocation of responsibilities for RDAR management across the three lines of defence. Firms must also be able to evidence how senior management uses the aggregated outputs as risk intelligence to inform strategic business decisions.

Fostering a Culture of Data Quality Management: Risk and control operating models, across the first and second lines of defence, must foster a culture of data quality management. Accountabilities for data quality management should be allocated across the organisation. The BCBS recommends designating data owners and setting up independent units for validating risk data and reporting processes. Firms should also consider the definition of key performance indicators (KPIs) to conduct checks on data quality, notably on data that informs the monitoring of, and decision-making on strategic risks.

Monitoring and Escalation Capabilities to Solve Implementation Challenges: Across firms, RDAR implementation roadmaps have faced persistent challenges due to range of challenges, such as insufficient resourcing, fragmented IT landscapes, lack of common taxonomy, and incomplete data lineage. In 2024, risk and control operating models should ensure that sufficient monitoring and escalation capabilities have been defined for programme owners to escalate key implementation risks to senior management. This will enable the prioritisation of investment, initiation of further programmes of work to solve dependencies, and undertake continuous improvements.



Banks should effectively address long-standing deficiencies and have adequate and effective RDAR frameworks in place to support efficient steering by management bodies and to address supervisory expectations, including in times of crisis.

ECB SSM Supervisory Priorities for [2024-2026](#)

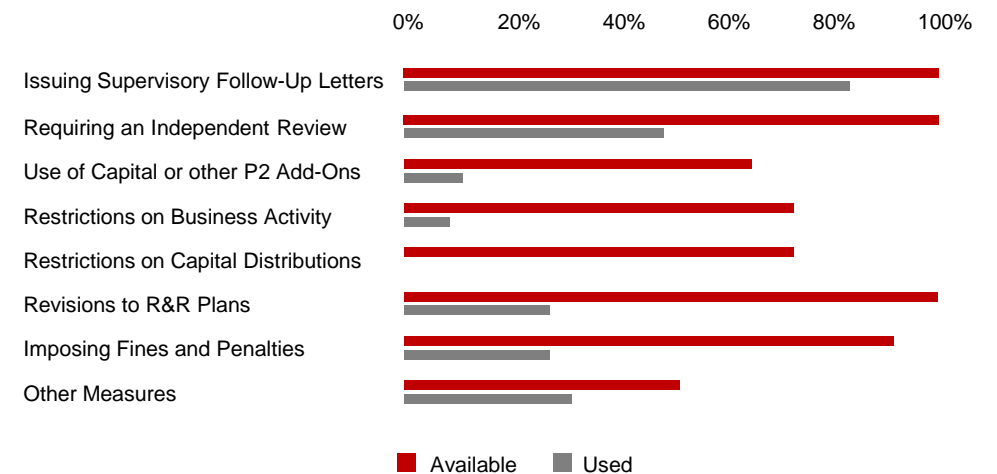


Figure 6: Availability and Usage of Supervisory Measures for Addressing RDAR Deficiencies - [BCBS November 2023](#)



5. Cultivate a Progressive Risk Culture

Both the ECB and the PRA have undertaken various initiatives throughout 2023 to emphasise the importance of firms adopting and cultivating a risk culture that promotes safety and soundness. In **Figures 7 and 8**, some of the key priorities identified by both regulators have been summarised. Key takeaways for risk and control operating model transformations have then been discussed.



Tone from the Top

- Composition of Management Bodies
- Functioning of Management Bodies
- Inclusion of Risk and Compliance Perspectives throughout the Bank
- Speak-up Culture, including Whistleblowing Mechanisms

Incentives

- Incentive Schemes (including Remuneration and Promotion)
- Consequence management to sanction misconduct behaviours

Accountability and Risk Ownership

- Effectiveness of the 3LOD
- Risk-based decisions, in line with risk appetite framework
- Strength and stature of risk management and internal control functions
- Escalation in case key metrics are breached
- Oversight appropriate to group's structural complexity (e.g. over entities and business lines)

Figure 7: Dimensions of Risk Culture – European Central Bank 2023

Key Takeaways

- Both the regimes are aligned in emphasizing the **importance of senior management** in driving the cultivation of a progressive risk culture. Diverse compositions of management bodies is a key starting point.
- Offering **clear financial and non-financial incentives** for positive behaviour is a key point of alignment, particularly as a tool for cascading culture down across all levels
- Beyond the definition of a culture strategy, both regimes expect firms to develop robust **monitoring and oversight mechanisms** to assess firm-wide effectiveness.



Desired Outcome

To improve diversity and inclusion (D&I) across PRA-regulated firms to support prudent decision-making, enhance risk culture, and reducing the risk of groupthink

How Can This Outcome be Achieved?

- Improving D&I for board and senior management, to enable the representation of a range of viewpoints and experiences
- Establishing accountability at a firm and individual level, with clear incentives to make progress
- Cultivating an inclusive culture that encourages staff across levels to shape strategic discussions on the firm's risk profile

Levers of Resulting Progress

- Strong embedment of D&I in firm culture and strategy
- Senior management accountability for D&I and risk culture
- Transparency in reporting and disclosures
- Ongoing monitoring and improvement mechanisms for culture

Figure 8: Policy Outcomes: CP18/23 – PRA/FCA 2023

TOM Considerations

- ✓ Review skills matrices of senior management members, remediate capability gaps, and assess effectiveness of firm-wide culture oversight mechanisms.
- ✓ Incorporate risk culture criteria within role objectives across all levels. This can include requirements to evidence improvements in risk culture awareness, such as completing training, or evidencing initiatives undertaken to cultivate an inclusive culture.
- ✓ Develop capabilities for monitoring progress against culture priorities, using tools such as management dashboards, internal forums, and third-party reviews.



6. Continued Focus on Climate Risk Management

Risks arising from climate change continue to be a top supervisory priority in 2024. Regulation adopted across key financial jurisdictions is very likely to not achieve the global warming targets defined in the 2015 Paris Agreement. In January 2024, an [ECB study](#) revealed that euro area banks' credit portfolios are significantly misaligned with the goals of the Paris Agreement (**Figure 9**), leading to transition risks for c.90% of the surveyed institutions. Delays in climate action is likely to significantly increase physical and transition risks. Firms should thus consider prioritising the alignment of their business and operating models with key climate and environmental (C&E) risks.

Risk and control functions in particular must prioritise the development of core capabilities to enable the achievement of firms' climate strategy. Key priorities include:

Genuine Embedment of Climate Risk Considerations into Operating Model: Various firms have suffered from poor climate risk outcomes as a result of treating it as an add-on endeavour that functions in a silo. There is often also a focus on achieving high ESG and climate risk scores from external agencies. However, to achieve lasting outcomes, firms must embed climate risk considerations into their corporate strategy. It must inform decision-making at the highest levels, shape product strategy, be governed by dedicated internal frameworks and capabilities, and benefit from a sound understanding across the organisation.

Assessing Maturity of Climate Risk Governance: The ECB's [2023 aggregated SREP results](#) revealed that whilst the management bodies of firms are expected to play a leading role in climate risk management, there continues to be significant deficiencies in their knowledge of climate risk and other related environmental, social, and governance (ESG) topics. Deficiencies were also noted in the effectiveness of firms' strategic and operational plans on embedding climate risk. These governance vulnerabilities have resulted in the Pillar 2 requirements of a greater number of banks being influenced by C&E risks compared to the SREP 2022. Thus, remediating key regulatory action points and assessing the maturity of climate risk frameworks is a top priority for firms.

Strengthening Disclosure Practices: A [2023 ECB study](#) on climate and environmental disclosures revealed that whilst the majority of significant institutions (SI) report at least basic data, the quality of reporting remains low. Disclosed data is often generic and the level of substantiation is insufficient. Hence, firms must clearly outline the strategic impact of the data on the resilience of their operating models. This includes articulating how the reported data is being used in strategic decision making and risk management. Where appropriate, using third-party reviews to assess quality of climate risk data and benchmarking underlying methodologies with the industry can be a useful tool.

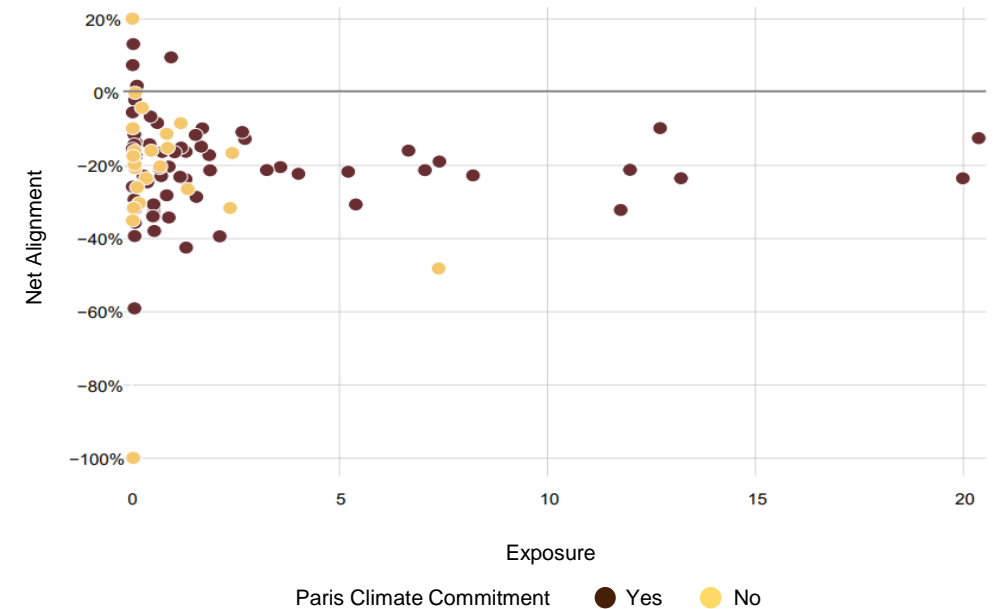


Figure 9: Net Alignment of Euro Area Banks with Paris Agreement – [European Central Bank 2023](#)



While firms are progressing their approaches to managing climate risks, there is still considerable work for all firms to do in their development of climate-related financial risk management capabilities and linking these more concretely into decision-making.

International Banks Supervision: 2024 Priorities – [PRA 2024](#)



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Vishwas is a trusted advisor to the C-Suite and senior management across a number of financial institutions with strong working relationships with industry associations, and academia and is a speaker at industry events and forums. He is also a member of the Institute of Directors, London.

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Adam is a Senior Consultant specialising in prudential risk and regulatory rule interpretation. He has led engagements with firms' C-Suite, and worked with regulatory bodies across Europe and the US.

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Previously, Adam worked as a financial regulator at the Bank of England (PRA), where he was engaged in the prudential regulation of global UK and US banks, international banks, and FMI's.



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Rayan is a Consultant with experience in supporting major financial institutions, across the entity and group levels, with operating model transformations, functional strategy development, organisational change, governance, risk, and regulation.

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